

**Review of the Audit and Compliance Section  
In the RRB's Bureau of Fiscal Operations  
Report No. 02-13, September 17, 2002**

This report represents the results of the Office of Inspector General's (OIG) review of the Audit and Compliance Section (ACS) in the Railroad Retirement Board's (RRB) Bureau of Fiscal Operations.

**BACKGROUND**

The RRB's mission is to administer retirement/survivor and unemployment/sickness insurance benefit programs for railroad workers and their families. During fiscal year (FY) 2001, the RRB paid approximately \$8.5 billion in railroad retirement and survivor benefits to about 700,000 beneficiaries. The RRB also paid unemployment and sickness insurance benefits of \$94.4 million to some 40,000 claimants.

Prior to 1991, the OIG developed and implemented a program to audit the payroll records of railroad employers. In 1991, the U.S. District Court, Northern District of Texas, ruled that the OIG lacked statutory authority to conduct tax compliance audits. On March 19, 1993, the agency's Board Members approved the establishment of the ACS within the Bureau of Fiscal Operations.

ACS conducts external audits of employers to ensure compliance under the Railroad Retirement Act (RRA) and Railroad Unemployment Insurance Act (RUIA), and verifies the accuracy of reported compensation and contributions. Although the section does not have the authority to audit taxes under the Railroad Retirement Tax Act (RRTA), its staff reviews the compensation amounts on which these payroll taxes are based.

In October 1999, the RRB and the Internal Revenue Service (IRS) implemented a coordination agreement for the administration of the RRTA by the IRS and the RRB's administration of the RRA. The IRS has also performed on-site safeguard reviews of ACS to evaluate the effectiveness of the RRB's measures to protect Federal tax data. The IRS conducted its most recent reviews on October 24-26, 2000 and March 23, 2001.

An error in reporting compensation generally results in a related error in reporting railroad retirement tax liability. ACS informs employers of additional potential railroad retirement tax liability, recommends that they report these amounts to the IRS, and provides employer audit results to the IRS.

ACS also gathers, verifies, and analyzes activities of employers and employees in support of the Board's coverage determinations under the RRA and the RUIA. This effort helps to ensure that those employees who work in the railroad industry receive the retirement and insurance benefits of coverage. ACS submits coverage cases to the Office of General Counsel (OGC), which drafts a preliminary decision that is forwarded to the Board for a formal determination.

For calendar year 2001, railroads reported to the RRB nearly \$28.5 billion in total compensation. During FY 2001, railroads paid approximately \$4.7 billion in railroad retirement taxes and \$50.7 million in RUIA contributions.

ACS currently consists of eight employees, including five auditors, one coverage specialist, one compliance management analyst, and one computer specialist. The administrative cost (salaries and equipment) for FY 2001 was approximately \$625,000.

In 1994, the Board Members approved general guidance procedures for ACS. The section follows the guidance provided by the General Accounting Office's Government Auditing Standards, commonly referred to as generally accepted government auditing standards (GAGAS). The section has prepared an audit guide that provides additional guidance for employer audits, and a coverage guide that provides guidance to auditors in addressing coverage issues.

The activities of ACS support the RRB strategic plan's goal to safeguard customers' trust funds through prudent stewardship. Employer audits and information gathered for determination of coverage allow the agency to ensure that railroad compensation and contributions are accurately reported.

### **OBJECTIVE, SCOPE AND METHODOLOGY**

The objective of this review was to assess the effectiveness of the ACS. The scope included its operations and activities from October 1999 through August 2002.

To accomplish the audit objective, we performed the audit steps detailed below:

- Reviewed the prior OIG audit findings (OIG Report No. 97-01, November 1, 1996);
- Reviewed applicable laws, regulations, policies and procedures, including the GAGAS, operating procedures, the coverage guide, and the audit guide;
- Examined various reports that contained information on operations, work volume, rotation of employer audits, staffing levels and administrative costs, and analyzed trends relating to this data;
- Examined workpapers for a judgmental sample of seven employer audits;
- Reviewed document files for a judgmental sample of 33 coverage cases;
- Examined the coordination and implementation agreement between the RRB and the IRS, and reviewed the most recent IRS safeguard report;
- Assessed coordination efforts between ACS and OIG's Office of Investigations;
- Held various discussions with ACS staff and management; and

- Held discussions with OGC management.

The OIG conducted the audit in accordance with generally accepted government auditing standards appropriate to this review. Auditors performed the fieldwork at the RRB headquarters office in Chicago, Illinois from March through August 2002.

## **RESULTS OF REVIEW**

Our review determined that ACS is generally performing its work according to Board-approved operating procedures. However, changes are needed in conducting employer audits to ensure more frequent audits of some of the larger railroads and consistent compliance with auditing standards and procedures. Improvements are needed for coverage reviews to ensure more timely coverage decisions, accurate reporting of the status of coverage cases, effective usage of reports that assess the status of coverage cases, and adequate documentation of procedures.

Detailed findings and recommendations are discussed below.

### **EMPLOYER AUDITS**

A timely and effective employer audit improves the accuracy of compensation reported for benefit computations and impacts the taxes and contributions paid by employers to fund benefit payments. Our review of a sample of employer audits and operating procedures determined that ACS is generally performing employer audits effectively.

ACS chooses audits from two groups of railroad employers, Class I and non-Class I. There are seven Class I railroads, employers with annual operating revenues of \$256.4 million or more. All other railroads are considered non-Class I. Our review determined that the audit rotation method for Class I employers is in compliance with Board-approved operating procedures, but ACS has not frequently audited a significant portion of the 50 largest non-Class I railroad employers. In addition, we determined that ACS does not always follow applicable standards and procedures for performing employer audits.

#### **Infrequent Audits of Larger Non-Class I Railroads**

Since the inception of ACS in 1993, the section has not audited 18 of the 50 largest non-Class I railroad employers.<sup>1</sup> The 18 unaudited non-Class I railroads had combined compensation of approximately \$640 million in FY 2001. Of the railroad audits conducted by the section, 14 of the largest non-Class I railroads were audited five or more years ago. These 14 non-Class I railroads had combined compensation of nearly

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<sup>1</sup> The OIG judgmentally selected the top 50 non-class I railroads in terms of the highest reported compensation for calendar year 2001 to determine when ACS last audited them. For 10 of the 18 railroads not audited by ACS, the OIG performed audits from 1990 through 1993. In addition, two railroads could not be audited because they are recent employers and had not accumulated three years worth of reporting history until 2002.

\$5.6 billion in 2001. Also, the section has not re-reviewed any of the larger non-Class I employers.

According to Board approved operating procedures, the larger non-Class I employers will be selected for audit based on auditing priorities and available resources, with additional weight being given to reviewing large non-Class I employers more frequently than smaller organizations.

The ACS has not adequately implemented Board operating procedures in order to ensure timely and frequent audits of larger non-class I railroads. ACS management has not defined the compensation criteria for larger non-class I railroads. ACS management explained that they plan to perform reviews of all larger non-Class I railroads before auditing those that have already been audited, regardless of whether ACS or the OIG performed the audit, and regardless of how long ago the audit took place. ACS also commented that limited staff resources have prevented the section from reviewing some non-Class I railroads more timely. The section lost two auditors prior to FY 2000 that have not been replaced.

Given the current workload, it will take many years for the section to audit all the larger railroads before reviewing them again. A risk of not auditing the larger railroads more frequently is that the RRB trust funds could be due additional, unrecognized funds in the form of railroad retirement taxes and contributions that result from ACS audit findings. The IRS may not be able to collect some of the additional potential railroad retirement tax since section 6501(a) of the Internal Revenue Code generally prohibits the assessment of any additional tax beginning 3 years after a return is filed. Section 8(k) of the RUIA incorporates the same 3-year statute of limitations for the assessment of contributions. Also, employees may lose creditable service and compensation because Section 9 of the Railroad Retirement Act provides for a four-year time limit for reporting credible service and compensation by employers.

#### Recommendation

The Audit and Compliance Section should reassess policies for performing employer audits by defining the criteria for larger non-Class I railroads, reviewing its audit selection process, and examining staff resources to ensure more frequent and timely audits of the larger non-Class I railroads (Recommendation #1).

#### Management's Response

The Audit and Compliance Section concurs with the recommendation, except for further defining the criteria for larger non-Class I railroads. The section believes that the current Board-approved operating procedures adequately define the larger non-Class I railroads. ACS also advised that, while additional staffing would allow the section to perform more employer audits, the agency has downsized significantly over the past decade and may be facing a hiring freeze in fiscal year 2003. The section will re-evaluate the audit selection process by July 2003. A complete copy of the response is included in Attachment I.

## OIG Comments

The OIG disagrees with ACS concerning the Board-approved operating procedures. These procedures state that for employer audits: “The second category shall include the larger non-class I employers. These employers will be selected for audit based on auditing priorities and available resources, with additional weight being given to reviewing large non-Class I employers more frequently than smaller organizations.” These Board procedures provide overall, general direction and it is therefore the responsibility of ACS to provide a more specific compensation criteria defining larger non-Class I railroads in order to fully implement the Board’s directive for more frequent audits of these railroads. In our discussions with ACS management, they indicated that they had not defined such criteria. While ACS has stated that they have audited 58% of the larger non-Class I employers, the fact that ACS has been in existence for about nine years indicates to the OIG that, without defining compensation criteria, it will take many years for the section to audit all the larger railroads before reviewing them again. The OIG did not verify the extent of audits performed for the Class II and Class III employers.

### Lack of Consistency in Following Audit Guide Procedures

ACS does not consistently follow the audit guide procedures for documenting and reviewing the workpapers. The OIG found exceptions in which some workpapers lacked properly documented conclusions. The OIG also found that the audit guide was not always reviewed monthly.

GAGAS states that workpapers aid the auditors in conducting and supervising the audit and allow others to review the audit’s quality. It also states that workpapers often are subject to review by other auditors and oversight officials. The implementation agreement between the RRB and the IRS indicates that the RRB will forward copies of any workpapers requested by the IRS.

The ACS audit guide requires that each workpaper group contain the name of the employer, purpose, source, and conclusion of the workpaper. A copy of the audit guide is included in the workpapers because it contains specific audit objectives and steps. The guide indicates that the ACS Chief should review this copy on a monthly basis.

ACS does not verify that the workpaper documentation meets the requirements specified in the audit guide because ACS management believes that the workpaper documentation and preparation is sufficient given the small size and extensive experience of the staff. The Chief of ACS believes that there is no need to review the audit guide monthly because he remains informed of the progress of each review through regular, informal discussions. However, the OIG believes that a workpaper checklist detailing major documentation and supervisory requirements would help to ensure the proper completion of work papers and frequency of supervisory review.

A risk of these conditions is that ACS staff may not satisfactorily complete their audit objective and audit steps. Credibility of the findings could possibly be challenged if ACS does not consistently document and review workpapers according to its audit guide and

the standards. In addition, it could take more time and effort for the IRS or another third party to understand the work completed.

#### Recommendation

The Audit and Compliance Section should ensure that audit staff follows the audit guide procedures by implementing the use of a workpaper checklist to validate the major requirements for documentation and supervisory review (Recommendation #2).

#### Management's Response

The Audit and Compliance Section concurs with the recommendation and will implement a workpaper checklist by October 2002. A complete copy of the response is included in Attachment I.

#### GAGAS Compliance Statement Not Consistently Included in ACS Audit Reports

The ACS employer audit reports do not always state that the reviews were conducted in accordance with GAGAS. Government Auditing Standards (1994 Revision), Sections 5.11 and 7.24, contains a reporting standard requiring that the audit reports should state that the audit was performed in accordance with GAGAS. The statement should be qualified in situations where the auditors did not comply with an applicable standard and an explanation should be provided.

GAGAS, which have been published since 1972, are broad statements of auditors' responsibilities and provide credible assurance of high quality audit effort, documentation and results. The agency's reliance on ACS auditors to perform comprehensive audits of railroad employers enhances the vital need to follow GAGAS. In addition, the implementation agreement between the agency and the IRS suggests that the IRS would have high interest in ACS audit reports and would seek reliance on their audit work.

ACS management advised the OIG that they follow GAGAS in performing employer audits. However, ACS improperly omitted the GAGAS statement in some audit reports due to oversight. If the GAGAS statement is not included in the employer audit report, the agency and the IRS may not realize that ACS is complying with an important and trustworthy standard. This may possibly put at risk the reliance of the agency and the IRS on the work and results of employer audits performed by ACS.

#### Recommendation

The Audit and Compliance Section should include a statement of compliance with GAGAS in all audit reports or include an explanation when there is a departure from the standards (Recommendation #3).

#### Management's Response

The Audit and Compliance Section concurs with the recommendation and has already begun including the GAGAS statement in all audit reports issued after August 15, 2002. A complete copy of the response is included in Attachment I.

## **COVERAGE REVIEWS**

An effective coverage review program helps to ensure that the appropriate taxes and contributions are collected to support the railroad retirement and unemployment and sickness insurance programs. Our review of a sample of coverage cases and the operating procedures in this area determined that improvements are needed to ensure more effective coverage decisions. There are no documented guidelines for the coverage specialist and compliance management analyst. ACS does not always follow set timeframes for the release of letters to the employer to enable the Board to make timely coverage determinations. ACS does not have follow-up procedures on cases sent to OGC for a decision. Also, ACS maintains a coverage control log as a monthly management report with data on the current status of coverage cases, but this log is inaccurate and is not always used to identify old cases.

### Lack of Written Procedures

There are no written guidelines for coverage reviews that support the general Board operating procedures.

Board operating procedures provide general guidance. According to the Board procedures, coverage reviews shall consist of conventional fact finding methods, including requests for information by way of correspondence.

Sound management practices call for written procedures. The coverage examiners follow guidelines developed by the RRB division that previously had responsibility for coverage development. The prior division did not document the guidelines, and ACS also did not document guidelines because of the extensive experience and knowledge of the coverage staff.

Written guidelines would aid in the training of a new coverage staff employee. Lack of documented guidelines makes it more difficult to timely and properly complete coverage reviews if one of the coverage employees left or went on extended leave.

Written guidelines would also ensure that cases are handled consistently, such as obtaining fact-finding information and following up on requests. Our review determined that the lack of documented guidelines for the follow-up timeframes for letters contributed to the inefficient processing of cases. We also determined that the lack of documented guidelines that explained the preparation, update and use of the control log contributed to inaccurate dates in the ACS coverage control log.

### Recommendations

The Audit and Compliance Section should:

- Document detailed guidelines that support the Board operating procedures for the coverage reviews conducted by coverage specialists (Recommendation #4).
- Include the follow-up timeframes for letters in the documented guidelines (Recommendation #5).
- Include the preparation, update and use of the control log in the documented guidelines (Recommendation #6).

### Management's Response

The Audit and Compliance Section agrees with the recommendations and will prepare guidelines for coverage reviews by February 2003. A complete copy of the response is included in Attachment I.

### Inefficient Processing Leads to Untimely Coverage Decisions

Coverage cases are not always processed efficiently to ensure timely coverage decisions. The OIG's sample review determined that ACS does not always send timely follow-up letters to the employers. In addition, ACS does not follow up on cases that it sends to the OGC.

The procedure that coverage specialists have implemented to obtain information from the employer includes follow-up timeframes of 30 days after their initial contact for sending a second letter, 25 days for the third letter and 20 days for the fourth letter. However, ACS has not documented the timeframe guidelines for these follow-up letters. In addition, the call-up system of manually inserting reminder notices into coverage case files is ineffective in ensuring timely follow-up. ACS also does not have any documented timeframe criteria or procedures for following up on cases sent to the OGC.

Delays in obtaining information from the employer contribute to lengthening the time it takes to make a coverage decision. From a judgmental sample of 33 cases, the OIG identified 12 cases with follow-up letters released 9 to 118 days late. Each case had one or more untimely letters. Lack of follow-up on cases sent to the OGC increases the risk that a coverage decision may not be timely. For example, as a result of this review, the RRB discovered that one case had not been submitted to the Board for a coverage decision. The case was to be submitted in May 2001 but the actual submission did not occur until June 2002.

### Recommendation

The Audit and Compliance Section should establish and document timeframe guidelines to follow-up on cases sent to the Office of General Counsel for which no request or decision has been received (Recommendation #7).

## Management's Response

The Audit and Compliance Section concurs with the recommendation and has partially implemented the recommendation by establishing the guidelines. A complete copy of the response is included in Attachment I.

## Control Log Is Inaccurate and Is Not Used Effectively

The ACS coverage control log is inaccurate and the log is not always used to identify old cases. The OIG determined that case opening dates recorded in the log are sometimes incorrect, and the log pending list is not always updated to record recent activity.

The control log contains detailed status comments as well as the dates that the cases were opened, closed, and sent to the OGC. These cases appear on the ACS control log's pending list. Every quarter, ACS sends the control log to all Board Members' offices as well as to management in the Bureau of Fiscal Operations and the Office of Programs. The control log is reviewed by ACS management to ensure timely follow-up of all coverage determinations according to a risk assessment prepared by the section.

In our sample review, we found one case that was a year older than the log indicated due to an inaccurate opening date that was entered into the log. We also identified several cases that remained on the pending list for which the Board Members had already rendered a decision in a previous year.

In addition to the entry of inaccurate dates into the log due to the lack of written guidelines, ACS is not effectively using the log to track timeliness, and to identify and resolve old coverage cases.

Inaccuracies in the control log data result in improperly depicting the status of some cases pending a coverage decision and the true age of some open cases. Inaccuracies also increase the risk that a coverage case will not be handled timely or properly, and impacts reporting of compensation and collection of taxes and contributions. For one OIG sample case, ACS discovered that it should have secured the railroad identification number in 1998.<sup>2</sup> A railroad identification number is typically secured for the purpose of the railroad to begin reporting compensation and paying contributions and taxes.

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<sup>2</sup> ACS management secured the railroad identification number after we brought this to their attention. There was no financial impact because this railroad had no employees. However, such an omission for a railroad with employees could have led to non-reporting of compensation and non-payment of taxes and contributions for several years, and possible losses in revenues for the RRB's trust funds.

## Recommendations

The Audit and Compliance Section should:

- Develop an automated system to ensure timely follow-up letters and contacts with the employers, the Office of General Counsel, and other parties (Recommendation #8).
- Use the control log to track timeliness and identify old, unresolved cases (Recommendation #9).

## Management's Response

The Audit and Compliance Section concurs with Recommendation #8 and will modify the control log database to include follow-up information by February 2003. ACS also agrees with Recommendation #9 and has already updated the control log to include aging data that tracks timeliness and identifies old, unresolved cases. A complete copy of the response is included in Attachment I.

**MEMORANDUM**

RAILROAD RETIREMENT BOARD

**SEP 06 2002**

**TO** : **Henrietta B. Shaw**  
**Assistant Inspector General for Audit**

**FROM** : **Kenneth P. Boehne** *Kenneth P. Boehne*  
**Chief Financial Officer**

**SUBJECT** : **Draft Report - Review of the Audit & Compliance Section in the RRB's Bureau of Fiscal Operations**

This is in response to your request for comments on the above draft audit report.

**Overall Report Comments:**

We are pleased with your conclusion that the Audit & Compliance Section (ACS) is generally performing its work in accordance with Board-approved operating procedures and generally performs employer audits effectively.

To further support this conclusion, it is important to point out that ACS has performed 16 Class I railroad audits and has audited 29 of the top 50 larger non-Class I employers. (Three of the top 50 larger non-Class I employers were not audited because they are recent employers or filed for bankruptcy.) The 2001 compensation reported by the audited employers totaled in excess of \$26.7 billion, or 94% of the combined year 2001 compensation base. This is in addition to auditing other Class II and Class III employers and completing investigations of companies for coverage purposes. In fiscal year 2001, over 150 coverage cases were closed. We believe that these accomplishments demonstrate that ACS has done a good job.

**Reply to OIG Recommendations:**

**Recommendation No. 1**

With additional audit staff resources, more employer audits can be performed and the audit frequency for the larger non-Class I employers increased. Our ability to audit the larger non-Class I railroads more frequently and timely is, however, dependent on the availability of additional staff resources. As you know, the agency has downsized by 35 percent over the past decade and may be facing a hiring freeze in fiscal year 2003.

We will implement this recommendation with the exception of further defining the criteria for larger non-Class I railroads. We believe that the current Board-approved operating procedures adequately define the larger non-Class I employers. We will review the ACS audit selection process in an effort to more frequently and timely audit the larger non-Class I railroads, given existing staff resources.

We wish to note, however, that ACS has followed the Board-approved operating procedures with respect to the selection of employers for audit. The Board-approved audit procedures are intended to not only ensure audit of the larger employers, but to ensure compliance from all classes of employers within the railroad industry. ACS's audit plan generally includes a minimum of 11-14 employer audits and coverage investigations annually. Included are Class I employers, larger non-Class I employers, and smaller Class II and III employers, in addition to required coverage investigations. We believe that this employer mix meets the Board's directive. Furthermore, applying the Office of Inspector General's draft report criteria, the ACS has audited (or audits are currently in process) 100% of the Class I employers, 58% of the larger non-Class I employers, and 15% of the Class II and Class III employers.

Planned Implementation: July 2003.

**Recommendation No. 2**

We agree and will continue to follow audit guide requirements relating to workpaper documentation and supervisory review. We will implement a workpaper checklist to further improve documentation of workpaper requirements and supervisory review.

Planned Implementation: October 2002.

**Recommendation No. 3**

We agree and have included the GAGAS statement in all ACS audit reports issued after August 15, 2002. The GAGAS statement was inadvertently omitted from some of the smaller non-Class I employer audit reports. Implemented.

**Recommendation Nos. 4, 5 and 6**

We agree and will develop written coverage guidelines to be followed by coverage examiners. These guidelines will include time frames for follow-up letters, and the preparation, update and use of the control log. Please note that delays in sending out follow-up letters are sometimes unavoidable. These delays include: 1) performing additional research to identify new contact officials, 2) requests from prospective employers for additional time to respond, 3) delays encountered in obtaining copies of specific contracts and leases before a case can be processed, and 4) requests from the Office of General Counsel (OCG) for additional information.

Planned Implementation: February 2003.

**Recommendation No. 7**

We agree and have already established an every other month follow-up process on the status of cases referred to the OGC. Implemented.

**Recommendation No. 8**

We agree and will modify the ACS control log database to include the follow-up date for letters and contacts with employers, the OGC and others. Planned Implementation: February 2003.

**Recommendation No. 9**

We agree and will use the control log to track timeliness of case activity. We have modified the control log database to produce an aging schedule of active cases. We are also performing a reconciliation every other month of cases pending with the OGC. Implemented.